

## Management's Discussion and Analysis

As management of the City of Annapolis, we offer readers of the City of Annapolis' basic financial statements this narrative overview and analysis of the financial activities of the City of Annapolis for the fiscal year ended June 30, 2003. We encourage readers to consider the information presented here in conjunction with the additional information that we have furnished in our letter of transmittal, which can be found on pages 1-4 of this report.

### Financial Highlights

- The assets of the City of Annapolis exceeded its liabilities at the close of the most recent fiscal year by \$59,227,317 (*net assets*). Of this amount, \$16,524,492 (*unrestricted net assets*) may be used to meet the city's ongoing obligations to citizens and creditors.
- The city's total net assets increased by \$2,958,538. Virtually all of this increase is attributable to ongoing revenues outstripping expenses over the past year. Governmental activities and business-type activities each accounted for this increase; \$553,921 and \$2,404,617, respectively.
- As of the close of the current fiscal year, the City of Annapolis' governmental funds reported combined ending fund balances of \$23,468,785, an increase of \$4,786,965 in comparison with the prior year. Of this amount, \$2,651,097, *is available for spending* at the city's discretion (*unreserved and undesignated fund balance*).
- At the end of the current fiscal year, unreserved undesignated fund balance for the general fund was \$2,708,502 or 7 percent of total general fund expenditures.
- The City of Annapolis' total debt increased by \$18,238,006 (68 percent) during the current fiscal year. The key factors in this increase were the issuance of \$20,885,000 of general obligation bonds and the issuance of \$7,690,000 refunding bonds in order to take advantage of favorable interest rates in effect during the last year to refinance existing debt.

### Overview of the Financial Statements

This discussion and analysis are intended to serve as an introduction to the City of Annapolis' basic financial statements. The city's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

**Government-wide financial statements.** The *government-wide financial statements* are designed to provide readers with a broad overview of the City of Annapolis' finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the city's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City of Annapolis is improving or deteriorating.

The *statement of activities* presents information showing how the city's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of the government-wide financial statements distinguish functions of the City of Annapolis that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City of Annapolis include general government, public safety, public works, economic environment, and culture and recreation. The business-type activities of the city include the water and sewer utilities, parking facilities, dock, market house, transportation, and refuse collection services.

The government-wide financial statements include only the City of Annapolis known as the *primary government*. The city does not have any *component unit* to report. The government-wide financial statements can be found on pages 21-23 of this report.

**Fund financial statements.** A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Annapolis, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the city can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

**Governmental funds.** *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the city's near term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City of Annapolis maintains three individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund, capital projects fund, and special revenue fund, all of which are considered to be major funds.

The City of Annapolis adopts an annual appropriated budget for its general fund. A budgetary comparison statement has been provided to demonstrate compliance with this budget.

The governmental fund financial statements can be found on pages 24-26 of this report.

**Proprietary funds.** The City of Annapolis maintains seven different types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City of Annapolis uses enterprise funds to account for its water and sewer utilities, parking facilities, dock, market house, transportation, and refuse collection services. *Internal service funds* are an accounting device used to accumulate and allocate costs internally for the City of Annapolis' self insurance activities. Because these services predominately benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide separate information for three of seven enterprise funds, which are considered to be major funds of the City of Annapolis and the remaining four funds are combined into a single, aggregated presentation. Individual fund data for the enterprise funds is provided in the form of *combining statements* elsewhere in this report. The internal service fund is presented in the proprietary fund financial statements. The proprietary fund financial statements can be found on pages 28-33 of this report.

***Fiduciary funds.*** Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are *not* reflected in the government-wide financial statement because the resources of those funds are *not* available to support the City of Annapolis' own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. The City of Annapolis uses a fiduciary fund to account for the Police and Fire pension plan. The fiduciary fund financial statements can be found on pages 34-35 of this report.

***Notes to the financial statements.*** The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 37-55 of this report.

***Other information.*** In addition to the basic financial statements and the accompanying notes, this report also presents certain *required supplementary information*, concerning the City of Annapolis' progress in funding its obligation to provide pension benefits to its police and fire employees. Required supplementary information can be found on page 56 of this report.

The combining statements referred to earlier in connection with non-major enterprise funds are presented immediately following the required supplementary information on pensions. Combining and individual fund statements and schedules can be found on pages 57-85 of this report.

### **Government-wide Financial Analysis**

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City of Annapolis, assets exceeded liabilities by \$59,227,317 at the close of the most recent fiscal year.

By far the largest portion of the City's net assets reflects its investment in capital assets (e.g., land, buildings, machinery, and equipment), less any related debt used to acquire those assets that is still outstanding. The City of Annapolis uses those capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. A statement of comparative analysis will be supplied in future years when comparative information is available.

**City of Annapolis**  
**Net Assets**

	<u>Governmental</u> <u>Activities</u>	<u>Business-type</u> <u>Activities</u>	<u>Total</u>
	<u>FY2003</u>	<u>FY2003</u>	<u>FY2003</u>
Current assets	\$33,369,965	\$10,170,739	\$43,540,704
Noncurrent assets:			
Restricted water and sewer capital facility assessments	-	5,892,325	5,892,325
Net Capital assets	<u>27,546,623</u>	<u>44,439,409</u>	<u>71,986,032</u>
Total noncurrent assets	<u>27,546,623</u>	<u>50,331,734</u>	<u>77,878,357</u>
Total assets	<u>60,916,588</u>	<u>60,502,473</u>	<u>121,419,061</u>
Current liabilities	11,056,383	3,912,794	14,969,177
Noncurrent liabilities	<u>19,826,146</u>	<u>27,396,421</u>	<u>47,222,567</u>
Total liabilities	<u>30,882,529</u>	<u>31,309,215</u>	<u>62,191,744</u>
Net assets:			
Invested in capital assets, net of related debt	5,901,817	21,038,093	26,939,910
Restricted	15,762,915	-	15,762,915
Unrestricted	<u>8,369,327</u>	<u>8,155,165</u>	<u>16,524,492</u>
Total net assets	<u>\$30,034,059</u>	<u>\$29,193,258</u>	<u>\$59,227,317</u>

An additional portion of the City of Annapolis' net assets represents resources that are subject to external restrictions on how they may be used. The remaining balance of *unrestricted net assets* may be used to meet the city's ongoing obligations to citizens and creditors.

At the end of the current fiscal year, the City of Annapolis is able to report positive balances in all three categories of net assets, both for the government as a whole, as well as for its separate governmental and business-type activities. The same situation held true for the prior fiscal year.

**Governmental activities.** Governmental activities increased the City of Annapolis' net assets by \$553,921, thereby accounting for 19 percent of the total growth in the net assets of the City of Annapolis. Key elements of this increase are as follows.

## City of Annapolis' Changes in Net Assets

	<u>Governmental</u> <u>Activities</u> <u>FY2003</u>	<u>Business-type</u> <u>Activities</u> <u>FY2003</u>	<u>Total</u> <u>FY2003</u>
Revenues:			
Program revenues:			
Charges for services	\$1,482,623	\$14,651,627	\$16,134,250
Operating grants and contributions	11,142,994	2,065,158	13,208,152
Capital grants and contributions	1,178,255	1,565,554	2,743,809
General revenues:			
Property taxes	19,048,995	-	19,048,995
Other taxes	-	-	-
Grants and contributions not restricted to specific programs	-	-	-
Other	<u>4,586,209</u>	<u>555,202</u>	<u>5,141,411</u>
Total revenues	<u>37,439,076</u>	<u>18,837,541</u>	<u>56,276,617</u>
Expenses:			
General government	6,361,730	-	6,361,730
Public safety	22,072,211	-	22,072,211
Community services	2,638,399	-	2,638,399
Community development	749,309	-	749,309
Public works	4,285,970	-	4,285,970
Interest on long term debt	777,536	780,548	1,558,084
Water	-	3,372,480	3,372,480
Sewer	-	4,315,505	4,315,505
Off street parking	-	992,154	992,154
Other	-	<u>6,972,237</u>	<u>6,972,237</u>
Total expenses	<u>36,885,155</u>	<u>16,432,924</u>	<u>53,318,079</u>
Change in net assets before transfers	553,921	2,404,617	2,958,538
Net assets at beginning of year, restated	<u>29,480,138</u>	<u>26,788,641</u>	<u>56,268,779</u>
Net assets at end of year	<u><u>\$30,034,059</u></u>	<u><u>\$29,193,258</u></u>	<u><u>\$59,227,317</u></u>

- Property taxes increased by \$861,619 (4.7 percent) during the year. This increase is the result of a rise in assessed values, the addition of new property through annexations, and new commercial construction. The city's real property tax rate remained constant at .624 per \$100 of assessed value.
- As in recent years the most significant dollar change in expenditures was in the public safety category, reflecting the city's continuing commitment to the protection of its citizens.

For the most part, increases in expenses closely paralleled inflation and growth in the demand for services. Two noteworthy exceptions, however, were the city's increase in public safety expenditures, where the largest dollar increase occurred, and in general government services, primarily the result of increased health care benefits.

**Business-type activities.** Business-type activities increased the City of Annapolis' net assets by \$2,404,617, accounting for 82 percent of the total growth in the city's net assets. Key elements of this increase are as follows.

- Capital contributions in the water and sewer utility funds of \$1,139,000 from capital facility assessments.
- Revenues exceeded expenses in the off street parking fund by \$850,000.
- Grants received in the dock fund increased \$55,500 (119%).

### **Financial Analysis of the Government's Funds**

As noted earlier, the City of Annapolis uses fund accounting to ensure and demonstrate compliance with finance related legal requirements.

**Governmental funds.** The focus of the City of Annapolis' *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the City of Annapolis' financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the City of Annapolis' governmental funds reported combined ending fund balances of \$23,468,785, an increase of \$4,786,965 in comparison with the prior fiscal year. Approximately 78% of this total amount, \$18,414,012 constitutes *unreserved fund balance*, subtracting \$15,762,915 designated for future capital and self insurance needs, \$2,651,097 is available for spending at the city's discretion. The remainder of fund balance is *reserved* to indicate that it is not available for new spending because it is already committed to liquidate contracts and purchase orders of the prior period of \$4,880,774 or for inventories and other prepaid items of \$173,999.

The general fund is the chief operating fund of the City of Annapolis. At the end of the current fiscal year, unreserved and undesignated fund balance of the general fund was \$10,271,902, while total fund balance reached \$10,930,200. As a measure of the general fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved and undesignated fund balance represents 28 percent of total general fund expenditures, while total fund balance represents 30 percent of that same amount.

The fund balance of the City of Annapolis' general fund decreased by \$4,021,693 during the current fiscal year primarily due to the planned use of prior year fund balances as pay-go funding for capital projects.

The capital project fund had an increase in its fund balance of \$8,808,658 partly due to the pay-go transfer from the general fund and due to the issuance of bonds during the year. As of June 30, 2003, the City had a \$325,000 commitment for renovations to the police department, \$1,434,000 for road improvements, \$1,400,000 for a comprehensive municipal software installation, and \$1,237,000 for new vehicle purchases. Subsequent to year end, the City entered into commitments of \$1,729,000 for additional road improvements and \$6,465,000 for a new parking garage.

**Proprietary funds.** The City of Annapolis' proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

Unrestricted net assets of the water utility amounted to \$731,271, those for the sewer utility amounted to \$2,640,710, those for the refuse collection fund amounted to \$770,795, those for the parking facilities amounted to \$3,730,567, and those for the transportation system amounted to \$(1,291,038). The negative unrestricted net assets in the transportation system are the result of expenses exceeding operating revenues and grants. The two non-major funds for the operation of the dock functions and the market house had combined unrestricted net assets of \$1,572,860. The total growth in net assets for the seven funds was \$2,404,617. Other factors concerning the finances of those funds have already been addressed in the discussion of the City of Annapolis' business-type activities.

### **General Fund Budgetary Highlights**

Differences between the original budget and the final amended budget were \$2,080,352 (increase in appropriations) and consist primarily of a supplemental appropriation for prior year commitments of \$718,950, additional grant funds from other governments of \$679,550, contributions of \$161,882, new bond interest and issue costs of \$164,230, and additional funding for snow removal of \$252,300.

### **Capital Asset and Debt Administration**

**Capital assets.** The City of Annapolis' investment in capital assets for its governmental and business-type activities as of June 30, 2003, amounts to \$71,986,032 (net of accumulated depreciation). This investment in capital assets includes land, buildings and improvements, machinery and equipment, park facilities, roads, highways, and bridges. The total increase in the City of Annapolis' investment in capital assets for the current fiscal year was 12 percent (a 16 percent increase for governmental activities and a 10 percent increase for business-type activities).

Major capital asset events during the current fiscal year included the following:

- Construction was completed on two storm drain projects.
- Installation of mobile data computing systems in police vehicles.
- Refurbishment and expansion of various park facilities.
- Vehicle fleet enhancements
- Various water distribution and storage system improvements were completed during the fiscal year.
- In the sewer utility fund, improvements at the wastewater treatment facility were completed.

**City of Annapolis' Capital Assets**  
(net of depreciation)

	Governmental <u>Activities</u>	Business-type <u>Activities</u>	<u>Total</u>
	<u>FY2003</u>	<u>FY2003</u>	<u>FY2003</u>
Land	\$4,099,953	\$3,243,442	\$7,343,395
Buildings	2,745,326	20,507,159	23,252,485
Improvements/infrastructure other than buildings	7,796,949	14,939,013	22,735,962
Equipment	3,280,037	2,185,164	5,465,201
Construction in progress	<u>9,624,358</u>	<u>3,564,631</u>	<u>13,188,989</u>
Total	<u>\$27,546,623</u>	<u>\$44,439,409</u>	<u>\$71,986,032</u>

Additional information on the City of Annapolis' capital assets can be found in note 6 on pages 46-47 of this report.

**Long-term debt.** At the end of the current fiscal year, the City of Annapolis had total general obligation bond debt outstanding of \$43,807,590. Other debt in the amount of \$1,238,532 are two outstanding State of Maryland loans.

**City of Annapolis' Outstanding Debt**

	Governmental <u>Activities</u>	Business-type <u>Activities</u>	<u>Total</u>
	<u>FY2003</u>	<u>FY2003</u>	<u>FY2003</u>
General obligation bonds	\$21,480,744	\$22,326,846	\$43,807,590
Other debt	<u>164,062</u>	<u>1,074,470</u>	<u>1,238,532</u>
Total	<u>\$21,644,806</u>	<u>\$23,401,316</u>	<u>\$45,046,122</u>

The City of Annapolis' total debt increased \$18,238,006 (68 percent) during the current fiscal year. The key factor in this increase was a \$20,885,000 bond issuance.

During the current fiscal year, the city refinanced some of its existing debt to take advantage of favorable interest rates. The city issued refunding bonds to refinance previously outstanding general obligation bonds. The result of the refunding transaction will be a reduction in future debt service payments of approximately \$650,000.

The City of Annapolis maintains ratings of "AA+" from Fitch, "AA" from Standard & Poor's, and "Aa2" from Moody's for its bonds. Additional information on the City of Annapolis' long-term debt can be found in note 7 on pages 49-51 of this report.

## **Economic Factors and Next Year's Budgets and Rates**

- The unemployment for the City of Annapolis area is currently 4.6 percent, which is an increase from the rate of 4.0 percent from a year ago. This compares favorably to the state's average unemployment rate of 5.5 percent and the national average rate of 5.6 percent.
- Inflationary trends in the region compare favorably to national rates.
- A median increase of 39.8% in taxable property valuation is projected for over the next three years beginning in 2004.

All of these factors were considered in preparing the City of Annapolis' budget for the 2004 fiscal year.

Rates in effect for the water and sewer utilities and the solid waste system will remain unchanged in the 2004 fiscal year.

## **Requests for Information**

This financial report is designed to provide a general overview of the City of Annapolis' finances for all those with an interest in the city's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of Finance, City of Annapolis, 160 Duke of Gloucester Street, Annapolis, Maryland, 21401.